U.S. Department of Justice

Environment and Natural Resources Division

HKH
DJ #90-11-3-08278

Environmental Enforcement Section
999 18th Street
South Terrance, Suite 370
Denver, Colorado 80202

Telephone (303) 844-1392
Facsimile (303) 844-1350

February 28, 2014

CONFIDENTIAL SETTLEMENT COMMUNICATION
Subject to Federal Rule of Evidence 408 and Confidentiality Agreement

Elizabeth H. Temkin, Partner
Joseph G. Middleton, Partner
Temkin Wielga & Hardt LLP
1900 Wazee Street, Suite 303
Denver, CO 80202

Dear Betsy and Joe:

This letter follows up on our conversation during the January 14, 2014 settlement meeting, and your letter dated January 23, 2014. For the reasons explained below, the United States disagrees with the legal analysis that you provided. It is clear under the law and the facts that Hecla Limited may be held derivatively liable under a veil-piercing theory for response costs under the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), 42 U.S.C. § 9607(a), related to the Gilt Edge Mine Site ("Site"). As discussed in more detail below, the United States also may seek a Writ of Garnishment and/or Writ of Sequestration against Hecla Limited for the value of the debt it owes to CoCa Mines, Inc. ("CoCa Mines") as a prejudgment remedy to our underlying CERCLA claims pursuant to the Federal Debt Collection Procedure Act ("FDCPA"), 28 U.S.C. §§ 3001, *et seq.* We are willing to meet in person to discuss these issues further, but we need a commitment from you to put a reasonable counter-offer on the table at the end of any such meeting.

<u>Piercing the Corporate Veil/ Derivative Liability</u>

CoCa Mines is a liable party at the Site.[1] CoCa Mines is the alter ego of Hecla Limited.[2] The evidence shows that there has been misuse of the corporate form by CoCa Mines and Hecla

[1] For an explanation of CoCa Mines' liability at the Site, please refer to the letter sent to Joe Middleton dated July 23, 2010. Additionally, the United States believes that CoCa Mines' liability may extend as far back as 1964 since neither Colorado nor South Dakota have identified records creating limited partnerships for Congdon & Carey Ltd, Congdon & Carey Ltd 3, or Congdon & Carey Ltd 5. Thus, these entities may be considered general partnerships, jointly and severally liable as successor companies through and including CoCa Mines, for ownership of and operations at the Site.

Limited to accomplish a wrongful purpose and which harms a rightful creditor, here the United States seeking recovery of response costs related to the Gilt Edge Mine Site. Furthermore, equity requires that the veil be pierced in this case to prevent injustice.

In *United States v. Bestfoods,* 524 U.S. 51, 52 (1998), the Supreme Court recognized separate theories of CERCLA liability: 1) direct operator liability by a parent that is so involved in operations at a facility as to control the facility; and 2) indirect/derivative liability under the established common law doctrine of veil-piercing.[3] Your letter argues that Hecla Limited cannot be held derivatively liable under *Bestfoods* because it was not in control of the subsidiary, either as an owner or operator, at the time of disposal of hazardous substances at the Site. *See* 1/23/2014 Letter at pp. 1-2. In order to pierce CoCa Mines' corporate veil, according to your argument, the harm must have been either the result of the parent's domination and control over the subsidiary, or at least the parent having disregarded the corporate form of the subsidiary during the same time period of the subsidiary's ownership/operations leading to CERCLA liability. *Id.* Your analysis conflates two distinct theories of liability into one, which is not only misleading but also inaccurate.

The Eighth Circuit also has ruled on this issue. In *United States v. Northeastern Pharmaceutical & Chemical Co., Inc.*, 810 F.2d 726, 744 (Eighth Cir. 1986) (*NEPACCO*), the Court recognized two distinct theories of liability under CERCLA: 1) individual/direct liability; and 2) indirect liability/derivative liability. "[T]his personal liability is distinct from derivative liability that results from 'piercing the corporate veil.'" *Id.* It is clear that both the Supreme Court in *Bestfoods* and the Eighth Circuit in *NEPACCO* recognize two separate theories of liability in the CERCLA context, and the second theory of liability (indirect/derivative liability under the doctrine of veil-piercing) is available to the United States in the case at hand. *See* 524 U.S. at 62-63; 810 F.2d at 744.

The correct legal question to analyze, therefore, is whether federal common law or state law applies to the Gilt Edge Mine Site case against CoCa Mines/Hecla Limited. Once the choice of law question is determined, we look to the appropriate court to provide a standard to apply. We start our analysis in the Eighth Circuit, where the underlying CERCLA action lies. The United States has found no Eighth Circuit decisions specifically addressing whether state or federal common law governs the determination of whether to pierce the corporate veil to determine indirect liability under CERCLA.[4] The Restatement (Second) of Conflicts of Law

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[2] For a listing of some of the factual evidence supporting a veil-piercing analysis, please see the power point presentation used by the United States during the April 19, 2013 settlement meeting, pp 25-41.

[3] The Supreme Court declined to rule on whether federal common law or state law should apply when determining whether a corporate veil should be pierced in the context of CERCLA. 524 U.S. at 63 n. 9 ("Since none of the parties challenges the Sixth Circuit's holding that CPC and Aerojet incurred no derivative liability, the question [of whether to apply federal common law or state common law to veil-piercing under CERCLA] is not presented in this case, and we do not address it further"). *Id.*

[4] The only 8th Circuit case that you cite, *United States v. TIC Inv. Corp.*, 68 F.3d 1082, 1086 (8th Circ. 1995) , did not address the issue of derivative liability under the doctrine of veil-piercing, thus it is inapplicable. *See* 68 F.3d at 1085 n.2: ("Because the district court did not reach the United States' alternative theory of derivative liability under the doctrine of piercing the corporate veil, we decline to express any opinion on that theory at this time. However, we note that this court has previously indicated, in dicta, that corporate veil-piercing may be appropriate where " 'the corporation is something less than a bona fide independent entity.' ")(*citing United States v. Northeastern Pharmaceutical & Chem. Co.,* 810 F.2d 726, 744 (Eighth Cir. 1986) (*NEPACCO*).

states that: "The local law of the state of incorporation will be applied to determine the existence and extent of a shareholder's liability of the corporation for assessments or contributions and to its creditors for corporate debts." *See* Restatement (Second) of Conflict of Laws § 307. The Eighth Circuit has stated generally that "[w]hether to pierce a corporate veil is a legal determination that ... is governed by state law," *See Stoebner v. Lingenfelter*, 115 F.3d 576, 579 (Eighth Cir.1997).[5] Thus, we can assume that the general rule applies to the case at hand, and turn our attention to the law of Colorado, where CoCa Mines is incorporated.[6]

As an initial matter, it should be noted that whether a veil can be pierced to prove derivative liability of a parent company is a mixed question of fact and law. *See McCallum Family L.L.C. v. Winger,* 221 P.3d 69, 73 (Colo.App. 2009). Thus, your contention during our January 14, 2014, meeting that these are merely legal issues that can be considered separately and apart from the facts of the Gilt Edge Mine Site case is wrong. *There can be no full analysis of the litigation risk posed to the parties without a discussion of both the facts of this case and how the law applies to them.* To do otherwise would be a disservice to our respective clients because it would be a truncated analysis. And while we agree that there may be some "common legal questions associated with the United States' claim against Hecla at both the Gilt Edge and Nelson Tunnel/Commodore Waste Rock Pile sites" (*See* 1/23/2014 Letter at p. 3), we believe that each case must be evaluated on its own merits. Thus, we decline to have a combined meeting of the teams.

The full discussion of the standard for piercing the corporate veil under Colorado law can be found at *McCallum Family*, 221 P.3d at 73-80. The burden of proof on the United States to show that the corporate veil of CoCa Mines should be pierced is preponderance of the evidence (as opposed to clear and convincing evidence). *Id.* at 73. In analyzing a veil-piercing claim, a court must make a three-part inquiry. *McCallum Family*, 221 P.3d at 74 (*citing In re Phillips*, 139 P.3d 639, 644 (Colo. 2006)).

First, the court must determine whether the corporate entity is the "alter ego" of the person or entity in issue. *Id.* The court may consider a variety of factors in determining status as an alter ego, including but not limited to whether: the corporation is not operated as a distinct business entity; funds and assets are commingled; adequate corporate records are maintained; the nature and form of the entity's ownership and control facilitate misuse by an insider; the business is thinly capitalized; the corporation is used as a "mere shell"; legal formalities are disregarded; and corporate funds or assets are used for non-corporate purposes. *Id.* Second, the court must

[5] Your reliance on *United States v. Wallace*, 961 F.Supp. 969, 978-79 (N.D.Tex. 1996), *IBC Mfg. Co. v. Velsicol Chemical Corp.*, 187 F.3d 635 (6th Cir. 999), *Bedford Affiliates v. Sills*, 156 F.3d 416, 431 (2nd Cir. 1998), *In re Advanced Packaging & Products Co.*, 426 B.R. 806, 823 (C.D. Cal 2010), is misplaced because of choice of law issues, as discussed above, and because you set forth no standard under federal common law for analysis of derivative liability under the doctrine of veil-piercing. You simply use these cases to promote the misleading and inaccurate argument that indirect/derivative liability is not available because Hecla Limited was not an owner/operator of the Site at the time of the disposal of hazardous substances. As stated previously, this argument conflates two distinct theories of liability into one.

[6] We note also that in *Wallace*, the court recognized a separate basis of indirect liability of the parent corporation that depletes the assets of the subsidiary: "de facto dissolution." Under the de facto dissolution theory, creditors may pursue the assets distributed to the shareholders/parent corporation " 'so long as the assets [are] traceable and [have] not been acquired by a bona fide purchaser.'" *Wallace*, 961 F.Supp. at 980 (*citing North American Sav. v. Metroplex Dev. Partnership,* 931 F.2d 1073, 1078 (5th Cir.1991)).

determine whether justice requires recognizing the substance of the relationship between the entity sought to be held liable and the corporation over the form because the corporate fiction was "used to perpetrate a fraud or defeat a rightful claim." *Id.* Third, the court must consider whether an equitable result will be achieved by disregarding the corporate form. "The paramount goal of piercing the corporate veil is to achieve an equitable result." *McCallum Family*, 221 P.3d at 74.

The inquiry into the first prong – the alter ego analysis -- "looks to the specific facts of each case, and not all of the listed factors need to be shown in order to establish alter ego status." *See Great Neck Plaza, L.P. v. Le Peep Restaurants, LLC,* 37 P.3d 485, 490 (Colo.App.2001). Here the evidence is undisputed that CoCa Mines is the alter ego of Hecla Limited because, among many other facts:

- **CoCa Mines is not operated as a distinct business entity from Hecla Limited:** 1) Parent corporation owns all or a majority of the capital stock of the subsidiary. *See e.g.* CoCa Mines' 104(e) Response (10/2/08) No.15; Hecla's U.S. Corporation Income Tax Returns, Form 851 "Affiliations Schedule"; 2) Parent corporation and subsidiary have common directors and/or officers. *See e.g.* CoCa Mines' 104(e) Response (1/7/11) No. 14; Hecla's annual reports to the SEC (Form 10-K) 2003-2011, Item 10 ("Directors and Executive Officers of Registrant"); 3) Parent corporation and subsidiary share same address/offices. *See e.g.* CoCa Mines' 104(e) Response (10/2/08) Doc. No. COCA-01 (letterhead with company address) and Response No. 2 (listing representatives from Hecla Limited with the same address);

- **Funds and assets of CoCa Mines and Hecla Limited commingled:** For example, accounts receivable (negative accounts payable) for transfer of Grouse Creek Property in 1993 still not paid by Hecla Limited to CoCa Mines. *See e.g.* CoCa Mines' 104(e) Response (8/11/11)/ Quitclaim Deed dated December 27, 1993/ COCA000746-47; Hecla Doc. No. 004507;

- **Adequate corporate records are not maintained:** It appears that Hecla Limited has been paying some or all of CoCa Mines' expenses over the years. For example, CoCa Mines showed on its 2008 tax returns $40 miscellaneous, $37,711 for reclamation, $3,229 for supplies and equipment and $812 for outside services, for a total of $41,792 in expenses. *See* CoCa Mines' U.S. Corporation Income Tax Return 2008; COCA000001. Based on its balance sheet, however, CoCa Mines could not have made these cash outlays; there are not adequate corporate records to explain how these expenses are being paid;

- **CoCa Mines is owned/operated in a way that allows Hecla Limited to misuse it:** For example, a 2008 resolution of the CoCa Board of Directors (*see above* "[p]arent corporation and subsidiary have common directors/officers") references a credit agreement between Hecla Mining Company and various lenders. Before approving the amendment to the agreement, the lenders required CoCa Mines to enter into various supplementary agreements (not provided as part of the 104(e) response). If CoCa Mines was providing a guarantee for Hecla Mining Company's loan, CoCa

Mines would have received no benefit from entering into such agreement and, if Hecla Mining Company defaulted on the loan, CoCa Mines could have been required to contribute its own resources to pay Hecla Mining Company's expenses. *See* CoCa Mines' 104(e) Response (1/7/11) No. 12; *see also* COCA000169-70;

- **CoCa Mines is thinly capitalized:** *See e.g.* CoCa Mines Balance Sheet and Income Statement (2003-2009)/ COCA000001; Hecla U.S. Corporation Income Tax Return (Form 1120) 2009; CoCa Mines' U.S. Corporation Income Tax Returns (Form 1120), 2005-2008;

- **CoCa Mines is used as a "mere shell" for Hecla Limited:** There are numerous examples of Hecla conducting business on behalf of CoCa Mines related to Creede Resources, Inc., a subsidiary of CoCa Mines. *See e.g.* Hecla Mining Company's 104(e) Response (to Nelson Tunnel Information Requests) (10/20/09)/ Doc. Nos. Hecla 104e-06792 through 06796; -06783 through 06784; -06656 through 06675;

- **Legal formalities are disregarded:** For example, Hecla arranged for and paid CoCa Mines' legal fees in the lawsuit of *George Creque, Jr. v. Cactus Mining Company Inc. et al.*, (1999 Superior Court/Ken County, CA). *See* Zurich Insurance's 104(e) Response (3/7/11) Doc. Nos. Zurich0000066-74 (EPA SDMS #1191226). In this same case, Hecla also filed an insurance claim under CoCa Mines' insurance policy to be reimbursed for a total of $329,097. *See* Zurich0000164-325. CoCa Mines was the insured party in this case;

- **CoCa Mines funds/assets are used for non-corporate purposes:** In 1985, CoCa Mines and Middle Butte Partners Limited (MBPL) entered into an agreement with Compass Mining, Inc., known as the Cactus Mining Venture Agreement, which created Cactus Gold Mines Company. *See* Hecla Mining Company's 104(e) Response (to Nelson Tunnel Information Requests) (10/20/09)/ Doc. Nos. Hecla 104e-24801. CoCa Mines was entitled to a management fee equal to two percent of the Cactus Gold Mines Company's net revenues. *Id.* at Hecla104e-24802. In 1994, Hecla submitted an SEC filing that stated it was the manager and entitled to this same fee. *See* Hecla Mining Company's Annual Report to the SEC (1994) (Form 10-K). There is no evidence that CoCa Mines ever transferred its interest in the Cactus Gold Mines Company to its parent company.

To satisfy the second prong of the veil-piercing test, the United States may show *either* that the corporate fiction is used to perpetrate a fraud or wrong, *or* that the corporate fiction is used to defeat the rightful claims of creditors. *McCallum Family*, 221 P.3d at 78-79. In this case, the United States can show both. The fraud or wrong being perpetrated is that CoCa Mines has no money to pay its debts. CoCa Mines makes this claim despite the fact that for approximately 13 years the company carried on its books a line item for an accounts receivable (negative affiliates payable) of up to $19 million. Instead, CoCa Mines claims that this transaction was actually a "return of capital" related to the purchase price of CoCo Mines' stock when the company was acquired by Hecla in 1991 (*see* Hecla Supplemental 104(e) Response

(5/26/11) in letter dated 8/11/11); *see also* COCA000001 (listing the $19 million from 2003-2009 as a "[r]eturn of capital"). CoCa Mines also states that this line item:

> reflect[s] initial accounting entries stemming from the initial transaction by which Hecla acquired CoCa in 1991, and do not actually reflect any income owed to CoCa . . . CoCa believes that the classification of these items as intercompany balances between CoCa and Hecla, rather than a return of capital, was a misclassification. Due to CoCa's general inactivity, the misclassification was not recognized for a number of years. The misclassification did not have a material effect on the financial statements, however the financial statements lacked clarity and therefore correcting entries were made.

See CoCa Mines' Letter Response (1/7/11) No. 8.

Tax returns from Hecla Mining from 1991 – 2000 clearly show that *at the time of the transaction* the companies viewed the transfer of ownership of the Grouse Creek property from CoCa Mines to Hecla Limited as a debt owed by the parent to the subsidiary. *See* Hecla Mining Company U.S. Corporation Income Tax Returns; *see also* Hecla 104(e) Response (10/17/2013) Document No. 004507; *see also* CoCa Mines tax returns through 2006 (which show a line item for accounts receivable (negative affiliates payable) for up to $19 million). This debt still has not been paid by Hecla Limited to CoCa Mines. In 2007, the $19 million accounts receivable disappears from CoCa Mines' books; however, this line item remained on Hecla Limited's 2007 Consolidated U.S. Corporation Income Tax Return. Contrary to CoCa Mines' assertion, whether it is owed $19 million from Hecla Limited has a very material effect on its finances. Additionally, neither CoCa Mines nor Helca Limited has explained in their 104(e) responses what other consideration, or value, CoCa Mines might have received for the transfer of its largest asset to the parent company in 1993. "[I]f it is shown that shareholders used the corporate entity as a mere instrumentality for the transaction of their own affairs without regard to separate and independent corporate existence, or for the purpose of defeating or evading important legislative policy, or in order to perpetrate a fraud or wrong on another, equity will permit the corporate form to be disregarded and will hold the shareholders personally responsible for the corporation's improper actions." *Micciche v. Billings*, 727 P.2d 367, 372-73 (Colo. 1986).

Additionally, Hecla Limited's treatment of CoCa Mines as its alter ego has left the company with no other appreciable sources of income, and no longer operational as a mining company. CoCa Mines is still a company organized and registered under the laws of Colorado, but it is unable to pay its expenses as they come due, or liquidate assets (if any are left) to pay its debts. This includes the debt that CoCa Mines owes the United States for response costs at the Site. There is no additional requirement to prove any conduct specifically directed at the United States or to show wrongful intent or bad faith on the part of CoCa Mines/Hecla Limited. All that the United States has to do to meet the requirement of the second prong is to show that the corporate fiction of CoCa Mines is being used to defeat the United States' rightful claim – here for response costs under CERLCA. *Martin v. Freeman*, 272 P.3d 1182, 1186 (Colo. App. 2012).

The third prong of the veil-piercing test is whether an equitable result will be achieved by disregarding the corporate form. *McCallum Family*, 221 P.3d at 79. In the case at hand, equity requires the veil to be pierced on CoCa Mines. If the veil is not lifted, the burden of paying for the cleanup at the Gilt Edge Mine Site will fall on the taxpayers rather than on CoCa Mines, a party that profited from mining at the Site. Additionally, other Defendants in this case already have paid their fair share of the cleanup costs, giving CoCa Mines/Hecla Limited an unfair business advantage if it does not do the same.

Federal Debt Collection Procedure Act

The FDCPA, 28 U.S.C. §§ 3001, *et seq.*, provides simplified procedures to obtain prejudgment remedies on claims for a debt to the United States. *See generally United States v. Teevan*, 862 F. Supp. 1200 (D.Del. 1992); *United States v. DeGregorio*, 510 F. Supp.2d 877 (M.D.Fla. 2007). To issue a prejudgment remedy, Section 3101(b) of the FDCPA requires the United States to file an affidavit that shows it has a "reasonable cause to believe" that the debtor:

> *has* or is about to assign, dispose, *remove, conceal*, ill treat, waste, or destroy property *with the effect of hindering, delaying, or defrauding the United States*;

28 U.S.C. §3101(b)(1)(B)(emphasis added). The United States must further show "the probable validity" of its claim for a debt. 28 U.S.C. § 3101(c). The affidavit must state "specifically the amount of the debt claimed by the United States and any interest or costs attributable to such debt." *Id.*

Here, the United States can show through the responses to 104(e) Information Requests and other documents cited herein that CoCa Mines has removed and/or concealed a debt owed to it from its parent company with the effect of preventing the United States from recovering response costs it is owed under CERCLA at the Site. 28 U.S.C. § 3101(b)(1)(B). The United States also can show with "probable validity" that CoCa Mines is a liable party at the Site as an owner/operator at the time of disposal of hazardous substances. *See United States v. Dickerson,* 790 F.Supp. 1583, 1585 (M.D.Ga.1992)(finding an action by the United States to recover CERCLA response costs an action on "a claim for a debt" pursuant to the meaning of the FDCPA). An affidavit from EPA will meet the requirement that the United States show with particularity the amount of the debt claimed by the United States (response costs related to the Gilt Edge Mine Site).

Section 3104 of the FDCPA addresses the pre-judgment remedy of garnishment, providing that "[i]f the requirements of section 3101 are satisfied, a court may issue a writ of garnishment against property (excluding earnings) in which the debtor has a substantial nonexempt interest and which is in the possession, custody, or control of a person other than the debtor in order to satisfy a claim for a debt." 28 U.S.C. § 3104(a). Section 3105 of the FDCPA addresses the pre-judgment remedy of sequestration, providing that "if the requirements of section 3101 are satisfied, a court shall issue a writ authorizing the United States to sequester income from property in which the debtor has a substantial nonexempt interest, as security for such judgment (and interest and costs) as the United States may recover on a claim for a debt ..." 28 U.S.C. § 3105(b).

As explained above, Hecla Limited owes CoCa Mines for the value of the Grouse Creek property which was transferred to Hecla Limited in 1993. By 2006, that value had grown to $19 million, according to tax returns. Interest should be applied to this value.[7] For a $19 million loan bearing interest at the prime rate +1 percent from January 1994 through December 2013 (compounded monthly), interest would be $59.13 million. This means that Hecla Limited owes CoCa Mines $78.13 million, and that debt is subject to a Writ of Garnishment and/or Writ of Sequestration against Hecla Limited as a prejudgment remedy to the United States' underlying CERCLA claims pursuant to the Federal Debt Collection Procedure Act ("FDCPA"), 28 U.S.C. §§ 3001, *et seq.*

Sincerely,

Heidi K. Hoffman

Heidi K. Hoffman

cc: Andrea Madigan, U.S. EPA
Sharon Abendschan, U.S. EPA
Amelia Piggott, U.S. EPA

[7] In 1991, then-Hecla Mining issued CoCa Mines a promissory note for a loan of $300,000 per month, secured by a mortgage on the Grouse Creek property. See Hecla 104(e) Response Doc. Nos. 000728-29, 000870-75. The loan was intended "... to finance the Grouse Creek project and other working capital requirements." *Id.* at 000728. Under the terms of this agreement, Hecla Mining charged CoCa Mines interest "at 1% above prime" *Id.* at 000729. The same terms and conditions of the 1991 loan is applied to the debt still owed by now-Hecla Limited to CoCa Mines for the value of the Grouse Creek property because it shows how the companies treated each other with regard to this particular asset.